Supreme Court, U.S.
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NO. 15-145

In the
Supreme Court of the United States

HUSKY INTERNATIONAL ELECTRONICS, INC.,

Petitioner,

v.

DANIEL LEE RITZ, JR.,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF IN OPPOSITION

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QUESTION PRESENTED

The Bankruptcy Code exempts from discharge "any debt ... for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by ... false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." 11 U.S.C. §523(a)(2)(A). The question presented is whether this provision applies when the debtor concededly made no misrepresentation that induced the creditor to turn over any money, property, services or credit, and instead is alleged only to have engaged in a fraudulent conveyance that aided a third party in evading that party's own preexisting debts to the creditor.

TABLE OF CONTENTS

QUESTION PRESENTED i
TABLE OF AUTHORITIES iii
INTRODUCTION 1
STATEMENT OF THE CASE 2
A. Statutory Background 2
B. Proceedings Below 4
1. Factual Background 4
2. The Bankruptcy Court's Decision 6
3. The District Court's Decision 7
4. The Court of Appeals' Decision 8
REASONS FOR DENYING THE PETITION 10
I. The Question Presented Does Not Arise With Sufficient Frequency To Warrant This Court's Review 12
II. The Decision Below Is Correct 16
III. Petitioner Could Not Prevail Even If The Court Were To Resolve The Question Presented In Its Favor 24
CONCLUSION 27

TABLE OF AUTHORITIES

Cases

In re Chrysalis Mfg. Corp.,
No. 08-33793 (Bankr. S.D. Tex.) 5

Field v. Mans,
516 U.S. 59 (1995)..... *passim*

Gleason v. Thaw,
236 U.S. 558 (1915)..... 24

Harris v. Viegelahn,
135 S. Ct. 1829 (2015)..... 2

Kawaauhau v. Geiger,
523 U.S. 57 (1998)..... 24

In re Lawson,
791 F.3d 214 (1st Cir. 2015) 12, 15, 20, 25

McClellan v. Cantrell,
217 F.3d 890 (7th Cir. 2000)..... *passim*

Miller v. J.D. Abrams, Inc.,
156 F.3d 598 (5th Cir. 1998)..... 8

Neal v. Clark,
95 U.S. 704 (1877)..... 23

United Student Aid Funds, Inc. v. Espinosa,
559 U.S 260 (2010)..... 23

Statutes

11 U.S.C. §548 21

11 U.S.C. §549 21

11 U.S.C. §550 21

11 U.S.C. §551 21

11 U.S.C. §552 21

11 U.S.C. §1322(a)(1) 2
11 U.S.C. §523(a) 6
11 U.S.C. §523(a)(2)(A) ..... *passim*
11 U.S.C. §523(a)(6) 10, 13, 22
11 U.S.C. §727(a)(2)(A) 13, 21
Texas Business Organization Code
Section 21.223(b) 5, 6, 7, 25

Other Authorities

3 Collier on Bankruptcy (16th ed.) 24
Black's Law Dictionary (10th ed. 2015) 18
Dkt. 1, Cmpl., *Husky Int'l Elecs. Inc. v. Ritz*,
4:09-cv-01532 (S.D. Tex. May 20, 2009) 5
Restatement (Second) of Torts (1976) 17
Restatement (Third) of Torts:
Liability for Economic Harm §9 Tentative
Draft No. 2 (2014) 18

INTRODUCTION

This case does not warrant this Court's review. Although the petition correctly identifies a circuit split on whether a misrepresentation is an element of "actual fraud" under section 523(a)(2)(A) of the Bankruptcy Code, that split has developed only in the past few months. In the 15 years prior, only a single Court of Appeals had ever had occasion to resolve that question. The question presented thus simply does not arise with sufficient frequency to warrant this Court's resolution.

Moreover, the decision below plainly got the answer to that question right. As this Court has recognized, the evident purpose of section 523(a)(2)(A) is to bar discharge of a debt that "follows a transfer of value or extension of credit induced by falsity or fraud." *Field v. Mans*, 516 U.S. 59, 66 (1995). Here, there is no allegation that the debtor induced the creditor to transfer any value or credit at all, let alone employed any fraud to do so. Instead, the only claim is that the debtor employed a fraudulent conveyance to help a third party avoid its own debt to the creditor. While such conduct certainly may, in some circumstances, render the recipient of a fraudulent conveyance liable for the debts of the party that made the transfer, it does not give rise to a debt that is nondischargeable under section 523(a)(2)(A). In all events, even if all three courts below were wrong about that, petitioner still would not be entitled to the relief it seeks, as there are several alternative grounds for affirming the conclusion that respondent does not owe petitioner any nondischargeable debt. Accordingly. the petition should be denied.

STATEMENT OF THE CASE

A. Statutory Background

"The Bankruptcy Code provides diverse courses overburdened debtors may pursue to gain discharge of their financial obligations, and thereby a 'fresh start.'" *Harris v. Viegelahn*, 135 S. Ct. 1829, 1835 (2015). For an individual debtor, the choice is typically between Chapter 7 and Chapter 13. A Chapter 7 bankruptcy "allows a debtor to make a clean break from his financial past, but at a steep price: prompt liquidation of the debtor's assets." *Id.* Although the debtor's debts are discharged entirely, subject to certain specified exceptions, the debtor's pre-petition assets are lost entirely as well. Chapter 13, on the other hand, is a "wholly voluntary alternative to Chapter 7" that "allows a debtor to retain his property if he proposes, and gains court confirmation of, a plan to repay his debts over a three-to-five year period." *Id.* Unlike under a Chapter 7 plan, "[p]ayments under a Chapter 13 plan are usually made from the debtor's 'future earnings or other future income.'" *Id.* (quoting 11 U.S.C. §1322(a)(1)). Accordingly, while Chapter 13 does not demand that the debtor give up all of his pre-petition assets, it also does not provide the same immediate "clean break" as Chapter 7; discharge instead comes only after the debtor has completed the plan for paying off his debts.

Certain debts are not dischargeable in a Chapter 7 or a Chapter 13 bankruptcy. As relevant here, in both contexts:

> (a) A discharge ... does not discharge an individual debtor from any debt—

> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by
>
> > (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition.

11 U.S.C. §523(a)(2)(A). As this Court explained in the course of extensively considering that provision in *Field*, the basic purpose of section 523(a)(2)(A) is to bar discharge "when the debt follows a transfer of value or extension of credit induced by falsity or fraud," 516 U.S. at 66—in other words, when the debtor employed falsity or fraud to get the creditor to part with whatever it was that gave rise to the debt.

Consistent with that purpose, and with *Field*'s holding that section 523(a)(2)(A) applies only when the creditor "justifiabl[y] reli[ed]" on the debtor's fraud, *id.* at 76-77, courts for years proceeded on the understanding that a creditor may invoke section 523(a)(2)(A) only when the debtor made a misrepresentation that induced the creditor to part with the money, property, services, or credit for which the debt is owed. In 2000, however, the Seventh Circuit gave section 523(a)(2)(A) a much broader reading, allowing a creditor to invoke it to bar discharge of a debt that was not for anything obtained from the creditor *at all*, let alone obtained by any fraudulent conduct. *See McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000). Instead, the debtor in *McClellan* had become liable for a debt that her *brother* owed the creditor because she obtained money

from *him* with knowledge that he was transferring it to her to evade *his* debt. According to the Seventh Circuit, section 523(a)(2)(A) still applied even though it was undisputed that the debtor did not induce the creditor to part with any money, property, services, or credit at all, let alone make a misrepresentation to the creditor to induce it to do so.

The question of whether section 523(a)(2)(A) may be invoked in the absence of a misrepresentation that induced the creditor to part with money, property, services, or credit arose only sparingly in the wake of *McClellan*, and no other Court of Appeals resolved it for the next 15 years.

B. Proceedings Below

1. Factual Background

This case involves an individual bankruptcy under Chapter 7 and a section 523(a)(2)(A) claim similar to the one pressed in *McClellan*. At all times relevant, respondent was a director and partial owner of Chrysalis Manufacturing Corporation, a company that manufactured electronic circuit boards. Pet.App.38a, 80a-81a. Although respondent was not involved in the company's day-to-day management, he did have financial control of Chrysalis. Pet.App.2a, 80a. From 2003 until 2007, petitioner sold and delivered electronic device components to Chrysalis pursuant to a written contract. Pet.App.80a. It is undisputed that respondent had no involvement in Chrysalis's negotiation of, entry into, or execution of that contract; instead, the only contact respondent "ever had with Husky was a telephone conversation ... after the parties had entered into a contract and Husky had already shipped" the components to

Chrysalis. Pet.App.83a. Chrysalis eventually stopped paying its debts to petitioner as they came due, resulting in an unsecured $163,999.38 debt for goods that petitioner had delivered to Chrysalis pursuant to their contract. Pet.App.81a-83a. While that debt was owing, respondent caused Chrysalis to make several transfers of its assets to other entities that he owned or controlled. Pet.App.81a-82a. Chrysalis ultimately filed for liquidation pursuant to Chapter 7 in 2008. *See In re Chrysalis Mfg. Corp.*, No. 08-33793 (Bankr. S.D. Tex.).

In 2009, petitioner initiated a diversity action against Chrysalis and respondent in federal district court seeking to hold respondent personally liable for Chrysalis's debt pursuant to section 21.223(b) of the Texas Business Organization Code, which allows piercing of the corporate veil to reach a director who "caused the corporation to be used for the purpose of perpetrating and did perpetrate an actual fraud on the obligee primarily for the direct personal benefit of the holder, beneficial owner, subscriber, or affiliate." Pet.App.39a. Petitioner alleged that respondent committed "actual fraud" under section 21.223(b) by causing Chrysalis to transfer its assets in an effort to evade paying its debt to petitioner. Pet.App.39a.[1]

A few months after petitioner brought that diversity action, respondent filed a Chapter 7 petition for bankruptcy. Petitioner responded by initiating

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[1] The claims for which petitioner sought to pierce Chrysalis's corporate veil are claims for breach of contract, common law fraud, recovery in quantum meruit, and breach of fiduciary duty. *See* Dkt. 1, Cmpl., *Husky Int'l Elecs. Inc. v. Ritz*, 4:09-cv-01532 (S.D. Tex. May 20, 2009).

this adversary proceeding in Bankruptcy Court, again alleging that respondent is personally liable under Texas law for Chrysalis's $163,999.38 debt, and seeking to prevent respondent from discharging that debt under three provisions of the Bankruptcy Code: (1) the "actual fraud" prong of section 523(a)(2)(A); (2) section 523(a)(4), which bars discharge of a debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny"; and (3) section 523(a)(6), which bars discharge of a debt "for willful and malicious injury by the debtor to another entity or to the property of another entity." 11 U.S.C. §523(a); *see* Pet.App.79a.

2. The Bankruptcy Court's Decision

Following a bench trial, the Bankruptcy Court concluded that petitioner "failed to establish any liability against" respondent under Texas law or that any of the exceptions to discharge that it invoked applies. Pet.App.79a.

As to the threshold state law question of whether respondent is liable for Chrysalis's debt at all, the court held that respondent did not cause Chrysalis to "perpetrate an actual fraud" on petitioner within the meaning of section 21.223(b) of the Texas Business Organization Code. Pet.App.91a-92a. Reviewing state and federal court decisions interpreting that provision, the court concluded that section 21.223(b) requires proof, *inter alia*, that the alleged fraudster made a material misrepresentation to the purported victim. Pet.App.92a. Because "[t]he record is wholly devoid of any such representation," the court concluded that petitioner could not establish that respondent is liable for Chrysalis's debt under Texas

law. Pet.App.92a. The court further concluded that the debt would not be exempted from discharge under section 523(a)(2)(A)'s "actual fraud" prong anyway because "the tests for fraud under section 22.223 ... and the requirements of section 523(a)(2)(A) ... are virtually the same." Pet.App.92a.

The court also concluded that petitioner could not establish an exception to discharge under section 523(a)(4) or section 523(a)(6). As to the former, the court found that respondent "owed no fiduciary duty to" petitioner. Pet.App.95a. As to the latter, although the court agreed with petitioner that the transfers respondent caused Chrysalis to make were not made in exchange for "reasonably equivalent value," Pet.App.81a, it found "[t]he record ... wholly devoid of any proof that [Ritz] willfully and maliciously injured Husky or Husky's property" by making those transfers. Pet.App.96a.

3. The District Court's Decision

Petitioner appealed the Bankruptcy Court's rulings under Texas law and sections 523(a)(2)(A) and 523(a)(6) of the Bankruptcy Code, and the District Court affirmed the Bankruptcy Court's decision. Although the District Court disagreed with the Bankruptcy Court's conclusion that a misrepresentation is an element of "actual fraud" under section 21.223(b) of the Texas Code, it agreed with the Bankruptcy Court that a misrepresentation is an element of "actual fraud" under section 523(a)(2)(A) of the Bankruptcy Code. Pet.App.72a. In reaching that conclusion, the court followed this Court's instruction in *Field* that section 523(a)(2)(A) should be interpreted in accordance with the common

law as understood when Congress enacted the modern Bankruptcy Code in 1978. Pet.App.72a. "Because the common law interpretation of §523(a)(2)(A) requires a misrepresentation and there is no evidence here that Ritz made one," the court concluded that "Husky's claim of nondischargeability under the statute fails." Pet.App.73a.

As to petitioner's alternative claim that the debt is nondischargeable under section 523(a)(6), the District Court agreed with the Bankruptcy Court that "'[t]he record is wholly devoid of any proof" that respondent "acted willfully and maliciously," Pet.App.75a (quoting Pet.App.96a)—*i.e.*, that he acted with "'either objective substantial certainty of harm or a subjective motive to cause harm,'" Pet.App.76a (quoting *Miller v. J.D. Abrams, Inc.*, 156 F.3d 598, 606 (5th Cir. 1998)).

4. The Court of Appeals' Decision

Petitioner appealed again, and the Court of Appeals unanimously affirmed. Like the District Court and the Bankruptcy Court before it, the Court of Appeals concluded that a creditor cannot establish "actual fraud" under section 523(a)(2)(A) when, as here, "the debtor made no false representation to the creditor" to induce it to turn over any money, property, services, or credit. Pet.App.8a.

"Guided by Supreme Court and Fifth Circuit precedent," the court began by acknowledging that this Court's decision in "*Field* made clear that the meaning of 'actual fraud' depends on the 1978 common law meaning of the term." Pet.App.7a, 12a. Reasoning that petitioner "has pointed to no authority. and we are not aware of any, suggesting

that the common law meaning of 'actual fraud' at that time encompassed fraudulent transfers" in which the debtor made no misrepresentation that induced the creditor to turn over money, property, services, or credit, the court concluded that section 523(a)(2)(A) does not reach such transfers. Pet.App.12a. Although the court acknowledged the Seventh Circuit's contrary conclusion in *McClellan* that any "actually fraudulent conveyances—i.e., conveyances through which the debtor *intends* to hinder the creditor—constitute 'actual fraud' under Section 523(a)(2)(A)," it found *McClellan* unpersuasive and "in tension with ... *Field*." Pet.App.8a, 9a.

In light of its conclusion that petitioner could not establish nondischargeability under section 523(a)(2)(A), the Court of Appeals saw no need to address the question of Texas law that divided the courts below. Pet.App.6a. The court also declined to address respondent's alternative arguments that any debt he owes to petitioner is not a debt for money, property, services, or credit "obtained by" fraud, 11 U.S.C. §523(a)(2)(A); that the relevant transfers were not made with intent to deceive petitioner; and that the relevant transfers actually were for reasonably equivalent value. Pet.App.7a, 3a & n.2.[2]

The Court of Appeals also affirmed the District Court's holding that the debt is not nondischargeable

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[2] At trial, respondent presented evidence that the transfers were made to repay those entities for loans that they had made to Chrysalis, and that the funds flowing into Chrysalis always exceeded the funds flowing out. *See, e.g.*, Appellee's Br. 57-59, 5th Cir. No. 14-20526, (Dec. 16, 2014) (ECF No. 00512872798).

under section 523(a)(6). Like both courts below, the Court of Appeals found "scant evidence in the record indicating either that Ritz made the[] transfers with the intent to harm Husky, or that harm to Husky was substantially certain due to Ritz's actions." Pet.App.18a. Accordingly, it agreed that petitioner failed to meet its "burden to prove" that respondent owes petitioner any debt "for willful and malicious injury by the debtor to another entity or to the property of another entity." 11 U.S.C. §523(a)(6).

REASONS FOR DENYING THE PETITION

This petition does not warrant this Court's consideration. Although petitioner correctly identifies a circuit split over whether "actual fraud" under section 523(a)(2)(A) requires a misrepresentation to the creditor, that narrow 2-1 division is the product of the first two Court of Appeals decisions to address that question in the past 15 years. The infrequency with which the question has arisen in the Courts of Appeals over the past two decades is unsurprising, as most frauds do involve a misrepresentation, rendering the question whether section 523(a)(2)(A) requires one of little practical importance. And that question is of even less importance given that the Bankruptcy Code contains provisions that speak much more directly both to situations in which a debtor has used a fraudulent conveyance to avoid his own debts (which is *not* what is alleged to have happened here) and situations in which, like this one, the debtor is alleged (albeit not actually proven) to have been the knowing recipient of a fraudulent conveyance with the intention of aiding a third party in evading that third party's debts.

To be sure, petitioner could not avail itself of those provisions here. But that is because, contrary to its repeated suggestions, petitioner did not actually prove that respondent engaged in "a deliberate fraudulent-transfer-scheme with intent to cheat a creditor." Pet.8. It instead at most proved only that respondent caused a third party to make transfers for less than reasonably equivalent value, which *no* court considers sufficient to constitute "actual fraud" under section 523(a)(2)(A). Yet it is *only* in a Chapter 7 case with that kind of evidentiary deficiency on the intent question that a creditor would need to try to resort to section 523(a)(2)(A) rather than just using section 523(a)(6). Accordingly, in the only circumstance in which the question presented actually matters in a Chapter 7 case, there is no circuit split to resolve.

That said, if the Court is inclined to resolve that question, it should do so in this Chapter 7 case, rather than in the Chapter 13 context that the pending petition out of the First Circuit's recent decision on this question presents, or at least should do so in both cases rather than just that Chapter 13 case. Although the question arises infrequently in either context, it arises even less frequently in the Chapter 13 context, and its resolution may turn at least in part on interpretation of provisions that (unlike 523(a)(2)(A)) apply only in the Chapter 7 context. Accordingly, while there is no need for the Court to resolve the question presented at all at this time, should the Court decide to do so, it should grant either this petition alone or this petition in combination with the *In re Lawson* petition, so that the interests of the Chapter 7 debtors who are more likely to be affected by resolution of the question are fully represented.

I. The Question Presented Does Not Arise With Sufficient Frequency To Warrant This Court's Review.

The petition correctly identifies a division among the Courts of Appeals on the question presented, but it is a shallow split that does not warrant this Court's review at this time. When the Fifth Circuit issued the decision below, only one other Court of Appeals had decided whether section 523(a)(2)(A) bars discharge of a debt that arises from a fraudulent conveyance in which the debtor made no misrepresentation that induced the creditor to part with any property, money, services, or credit. *See McClellan*, 217 F.3d at 894. Petitioner identifies only a handful of Bankruptcy or District Court cases in which that issue was resolved in the 15 years following. *See* Pet. 14-15 nn.2 & 3. And it was only in the past four months that the Fifth Circuit became the first Court of Appeals to reject the Seventh Circuit's position, and the First Circuit the first to adopt it. *See In re Lawson*, 791 F.3d 214 (1st Cir. 2015), petition for cert. filed, No. 15-113 (July 27, 2015) (response requested Sept. 15, 2015).

Petitioner attempts to explain away the dearth of Court of Appeals cases resolving the question presented as the product of an emphasis on settlement in bankruptcy, Pet.15, but the more likely explanation is that the issue simply does not arise with any real frequency. And it is not hard to see why. As the Seventh Circuit pointed out in *McClellan*, "[m]ost frauds do involve misrepresentation," *McClellan*, 217 F.3d at 893, rendering the question whether section 523(a)(2)(A) applies to a fraud that lacks one academic. Moreover, as Judge Ripple explained in his

skeptical concurrence in *McClellan*, the rare fraud that does *not* involve a misrepresentation likely involves facts sufficient to satisfy section 523(a)(6)'s bar on discharge of debts "for willful and malicious injury by the debtor to another entity or the property of another entity," 11 U.S.C. §523(a)(6). *See McClellan*, 217 F.3d at 896 (Ripple, J., concurring). Indeed, Judge Ripple found that provision the "far more direct avenue for dealing with a situation such as the one [the court] ha[d] before" it, *id.*, and the majority did not disagree that it may well have covered the allegations at hand, *see id.*

To the extent petitioner's concern is with Chapter 7 debtors who employ fraudulent conveyances to evade paying *their own* debts—an entirely different scenario from what is alleged to have happened here—the Bankruptcy Code already covers that scenario as well. Section 727(a)(2)(A) provides an absolute bar to discharge for a Chapter 7 debtor who, "with intent to hinder, delay, or defraud a creditor ... has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed ... property of the debtor, within one year before the date of the filing of the petition." 11 U.S.C. §727(a)(2)(A). Petitioner presumably did not invoke that provision here because respondent is not alleged to have employed fraudulent transfers to evade his *own* debts. He is alleged to have employed fraudulent conveyances to aid *Chrysalis* in evading *Chrysalis*'s debts—conduct that (at least if undertaken with the requisite intent) fits much more comfortably into the category of "willful and malicious injury by the debtor to another entity or the property of another entity," 11 U.S.C. §523(a)(6), than

employing "actual fraud" to "obtain[]" money, property, services, or credit from that entity, *id.* §523(a)(2)(A).

To be sure, petitioner failed to prove that section 523(a)(6) bars discharge in this case. But that is not because that provision cannot reach "a deliberate fraudulent transfer-scheme with intent to cheat a creditor." Pet.8. It is because, notwithstanding petitioner's repeated suggestions otherwise, the courts below did not find that respondent engaged in such a scheme. While the Bankruptcy Court found that respondent caused Chrysalis to make transfers for which it did not receive "reasonably equivalent value," Pet.App.81a, all courts agreed that petitioner presented virtually no evidence to support its assertion that respondent "made the[] transfers *with the intent to harm*" petitioner. Pet.App.18a (emphasis added).[3] And *no* court thinks that making transfers for less than "reasonably equivalent value" constitutes

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[3] While the District Court did suggest that the evidence was sufficient to demonstrate "intent to commit actual fraud" under Texas law, the court did so based only on the circumstantial evidence that the state's "badges of fraud" provision allows a court to take into consideration. Pet.App.71a-72a. When it came to examining respondent's intent under section 523(a)(6), the District Court agreed with the Bankruptcy Court that petitioner failed to prove that respondent caused Chrysalis to make the transfers with "'a subjective motive to cause harm'" to petitioner. Pet.App.76a. Although the Fifth Circuit had no occasion to resolve the intent question under Texas law, it too found when resolving the intent question under section 523(a)(6) that petitioner failed to prove that respondent "made the[] transfers with intent to harm" petitioner, Pet.App.18a—*i.e.*, with the "intent to cheat a creditor" that petitioner repeatedly attempts to ascribe to him.

"actual fraud" under section 523(a)(2)(A). To the contrary, the Seventh and the First Circuits both expressly distinguished "constructive" fraud—*i.e.*, where "the only evidence of [fraud] is the inadequacy of the consideration"—from "actual" fraud—*i.e.*, where "the debtor intended by the transfer to hinder his creditors"—and interpreted section 523(a)(2)(A) to reach only the latter. *McClellan*, 217 F.3d at 894; *see also In re Lawson*, 791 F.3d at 220 ("our holding is limited to cases of *actual*, as opposed to merely constructive, fraud").

While that means that this case does not actually present the question that petitioner has posed, it also underscores why there is no need to resolve that question at all. Precisely because section 523(a)(6) is available when a Chapter 7 debtor really has engaged in a fraudulent transfer scheme with intent to cheat the transferee's creditor, it is *only* the rare case in which the creditor cannot prove that intent that it would need to try to resort to section 523(a)(2)(A). But, again, *no* court thinks that section 523(a)(2)(A) reaches a fraudulent transfer scheme in which the debtor did not act with intent to injure the creditor. Accordingly, on the only question of any practical consequence in the Chapter 7 context, there is no circuit split at all.

Of course, neither section 523(a)(6) nor section 727(a)(2)(A) applies in Chapter 13 proceedings. Accordingly, if there really were a large number of debtors engaging in frauds that involve no material misrepresentation to the creditor, then one would expect to see a disproportionately high number of Chapter 13 cases involving the question presented. In

fact, it is just the opposite; the question has arisen with even less frequency in the Chapter 13 context than the Chapter 7 context. Indeed, of the various Bankruptcy Court cases petitioner cites, only two (plus *In re Lawson*) are Chapter 13 cases. *See* Pet.14-15 nn.2 & 3. That is just further confirmation that the Seventh Circuit was correct when it observed that "[m]ost frauds do involve misrepresentation," *McClellan*, 217 F.3d at 893, making whether section 523(a)(2)(A) applies in the absence of a misrepresentation a question of minimal practical importance that does not warrant this Court's review.

II. The Decision Below Is Correct.

This Court's review also is unwarranted because the decision below is correct, as were the two decisions below it that the Fifth Circuit affirmed. Under a straightforward application of the same statutory construction tools that this Court applied in *Field*, section 523(a)(2)(A) plainly does not bar discharge of a debt that is not the product of a misrepresentation that induced the creditor to part with money, property, services, or credit.

1. Section 523(a)(2)(A) renders nondischargeable:

> (a) ... any debt—
>
> > (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by
> >
> > > (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition.

11 U.S.C. §523(a)(2)(A). As this Court has explained, the term "actual fraud" is a "common-law term" that "carr[ies] the acquired meaning of [a] term[] of art." *Field*, 516 U.S. at 69. Accordingly, to determine the elements of "actual fraud" under section 523(a)(2)(A), courts must "look to the concept of 'actual fraud' as it was understood" when section 523(a)(2)(A) was enacted in 1978, and to the "elements that the common law has defined [that concept] to include." *Id.* at 69-70.

To answer that very same question in *Field*, this Court looked principally to sections 537 and 540 of the Restatement (Second) of Torts (1976), "the most widely accepted distillation of the common law of torts" in 1978. *Id.* at 70. Those sections require a misrepresentation upon which the victim justifiably relied to its detriment. *See* Restatement (Second) of Torts (1976) §§537, 540. So, too, does section 871, on which the First Circuit heavily relied in *In re Lawson*. *See id.* §871 cmt. (e) ("The actor's conduct is fraudulent if he intentionally causes another to act or refrain from acting by means of intentionally false or misleading conduct or by his intentional concealment of facts or by his intentional failure to disclose a fact that he has a duty to reveal to the other."). To be sure, as section 871 reflects, the term "misrepresentation" is a broad one that encompasses "not only words spoken or written but also any other conduct that amounts to an assertion not in accordance with the truth." *Id.* §525 cmt. (b). But the irreducible minimum of "actual fraud" at common law is some sort of false statement or conduct on which the victim relied.

That proposition should hardly be controversial. One of the core distinctions between actual fraud and other torts is that actual fraud injures the victim *by inducing reliance*. *See, e.g.*, Black's Law Dictionary (10th ed. 2015) ("actual fraud: A concealment or false representation through an intentional or reckless statement or conduct *that injures another who relies on it in acting* (emphasis added)); Restatement (Third) of Torts: Liability for Economic Harm §9 Tentative Draft No. 2 (2014) (defining "fraud" as "mak[ing] a material misrepresentation of fact, opinion, intention, or law, *for the purpose of inducing another to act or refrain from acting*" (emphasis added)). Actual fraud thus, by definition, must involve some statement or conduct on which the victim could have relied in the first place. If there is no such misrepresentation, then there can be no reliance. And if there is no reliance, then there can be no actual fraud. Accordingly, when Congress incorporated the common-law term "actual fraud" into section 523(a)(2)(A), it also incorporated the settled understanding that actual fraud requires some misrepresentation on which the creditor relied.

2. That conclusion is confirmed by the surrounding statutory text. Section 523(a)(2)(A) bars discharge of any debt "*for* money, property, services, or an extension, renewal, or refinancing of credit, *to the extent obtained by* ... actual fraud." 11 U.S.C. §523(a)(2)(A) (emphasis added). The italicized language is critical, first, because, as this Court recognized in *Field*, "some degree of reliance is required to satisfy the element of causation inherent in the phrase 'obtained by.'" *Field*, 516 U.S. at 66. Indeed, there would have been no need for this Court to decide "what, if any, level of justification a creditor

needs to show above mere reliance in fact in order to exempt the debt from discharge under" the "actual fraud" prong of section 523(a)(2)(A) if the statute could apply in the absence of any reliance at all. *Field*, 516 U.S. at 66; *see also id.* at 70 & n.8 (confirming that Court was interpreting "actual fraud" prong). By using language that requires the creditor to have relied on the debtor's fraudulent statement or conduct, Congress confirmed its understanding that actual fraud requires some misrepresentation on which the creditor could have relied in the first place.

Moreover, "[t]he language 'obtained by' clearly indicates that ... the debtor committed a fraudulent act *to induce the creditor to part with his money or property*." *McClellan*, 217 F.3d at 896 (Ripple, J., concurring) (emphasis added). Indeed, the whole point of section 523(a)(2)(A) is to bar discharge "when the debt follows a transfer of value or extension of credit induced by falsity or fraud," *Field*, 516 U.S. at 66—in other words, when the debt is *for* money, property, services, or credit with which the debtor *induced the creditor* to part. That "causal connection between the misrepresentation and the transfer of value or extension of credit" by the creditor is the very heart of section 523(a)(2)(A). *Id.* at 67

That makes section 523(a)(2)(A) an incredibly poor fit for the type of fraudulent conveyance alleged here. Not only is it undisputed that respondent made no misrepresentation that induced petitioner to part with any money, property, services, or credit; it is undisputed that respondent obtained no money, property, services, or credit from petitioner *at all*. Instead, the only things of value with which petitioner

parted are the goods that it provided to *Chrysalis*—goods provided pursuant to a contract between those two parties that respondent concededly played no role in procuring. And that fact pattern is hardly unique to this case. The debtor in *In re Lawson* was alleged to have accepted fraudulent conveyances from her father to help him evade a debt that he already owed the creditor, wholly independent of any actions on her part. *See In re Lawson*, 791 F.3d at 216. Likewise, in *McClellan*, the debtor was alleged to have accepted fraudulent conveyances from her brother to help him evade a debt that he already owed the creditor, again wholly independent of any actions on her part. *See McClellan*, 217 F.3d at 892.

What is utterly lacking in each of those scenarios is any effort to "*induce the creditor* to part with his money or property." *McClellan*, 217 F.3d at 896 (Ripple, J., concurring). Instead, the only fraudulent conveyance alleged is one that did not involve the creditor at all, let alone any of his money or property. The Seventh Circuit attempted to get around that glaring flaw in its construction of section 523(a)(2)(A) by reasoning that "the statute does not require that the transferor *be the victim* of the fraud, but only that money, property, or services be obtained by fraud." *Id.* at 895 (emphasis added). But that flies in the face of this Court's decision in *Field*, which interpreted section 523(a)(2)(A) as applying only "when the debt follows a transfer of value or extension of credit induced by falsity or fraud." *Field*, 516 U.S. at 66. While receiving a fraudulent conveyance to help a third party avoid a debt that follows a transfer induced something else entirely certainly may, in the right circumstances, suffice to render the recipient liable for

the underlying debt, it does not create a debt "for money, property, services, or an extension, renewal, or refinancing of credit ... obtained by ... actual fraud." 11 U.S.C. §523(a)(2)(A).

3. Of course, none of that is to suggest that the Bankruptcy Code has nothing to say about debtors who use fraudulent conveyances to evade creditors. What it has to say about them just isn't found in section 523(a)(2)(A). First, petitioner's extensive reliance on treatises and cases dealing with debtors who conceal their *own* assets to avoid paying their *own* debts is entirely misplaced. *See* Pet.16-18. Not only is that manifestly not what this case is about; it is also something that the Bankruptcy Code already addresses in multiple ways. As the very sources on which petitioner relies confirm, when a debtor has fraudulently transferred *his own* assets with intent to evade *his own* creditors, the transfer typically may be invalidated and the assets returned to the estate for the creditors' benefit. *See, e.g.*, 11 U.S.C. §§548-52. Moreover, as explained, section 727(a)(2)(A) provides an absolute bar to discharge for a Chapter 7 debtor who, "with intent to hinder, delay, or defraud a creditor ... has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed ... property of the debtor, within one year before the date of the filing of the petition." 11 U.S.C. §727(a)(2)(A).

Petitioner complains that section 727(a)(2)(A) may not apply "where the debtor only *received* a fraudulent transfer" from some *other* debtor, with the intent to evade *that* debtor's creditors, rather than

making a fraudulent transfer with the intent to evade his own. Pet.20. But there is no need to stretch section 523(a)(2)(A) to reach that situation either, as that, too, is something that the Bankruptcy Code already addresses through section 523(a)(6). *See supra* pp.12-14. Unlike section 523(a)(2), section 523(a)(6) is not confined to "debt[s] ... for money, property, services, or an extension, renewal, or refinancing of credit ... *obtained by*" the tortious conduct; it instead applies to "any debt ... for willful and malicious injury by the debtor," 11 U.S.C. §523(a)(6), a standard that the courts here described as satisfied by proof of "either an objective substantial certainty of harm or a subjective motive to cause harm." Pet.App.17a, 76a. Section 523(a)(6) thus supplies a "far more direct avenue for dealing with a situation" in which the debtor has participated in an asset transfer to intentionally cheat a creditor out of money owed to it by someone else. *McClellan*, 217 F.3d at 896 (Ripple, J., concurring).

To be sure, those provisions do not apply in Chapter 13 proceedings. But neither did section 523(a)(2)(A) until Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), which extended some (but not all) of the Chapter 7 discharge bars to the Chapter 13 context. Congress thus cannot possibly have enacted section 523(a)(2)(A) to "serve[] an independent purpose ... in Chapter 13" cases, Pet.21, as section 523(a)(2)(A) did not even apply to Chapter 13 cases when it was enacted. Nor is petitioner's reading of section 523(a)(2)(A) needed to prevent "'especially clever' debtors" from "avoid[ing] any discharge bar by filing for bankruptcy under Chapter 13 instead of

Chapter 7" Pet.22. Congress made a conscious decision to keep "[a] discharge under Chapter 13 ... 'broader than the discharge received in any other chapter,'" *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 268 (2010), because a Chapter 13 bankruptcy requires approval and completion of a plan for *paying* the debtor's creditors. Allowing creditors to smuggle section 523(a)(6) claims into section 523(a)(2)(A) thus would undermine Congress's intent to encourage use of a provision under which creditors are more likely to be paid by expanding the scope of the discharge available upon completion of the plan.

Finally, petitioner's boundless construction of section 523(a)(2)(A) is not necessary to avoid any superfluity problems either. Although petitioner proceeds on the assumption that "actual fraud" must encompass a broader swath of conduct than "false pretense" or "false representation," this Court has recognized the possibility of "a case of false pretense or representation but not of fraud." *Field*, 516 U.S. at 70 n.8. That conclusion is perfectly consistent with the fact that "the statute *already* referred specifically to 'false representation[s]' before 1978," Pet.19, as Congress had *already* barred discharge of a "debt created by the fraud ... of the bankrupt" for more than a century as well. *See Neal v. Clark*, 95 U.S. 704, 706 (1877). The 1978 code just recodified that long-standing bar and added the caveat "actual." As the leading bankruptcy treatise thus explains, the "actual fraud" prong in section 523(a)(2)(A) was intended not to make any "change in the law as it existed prior to" 1978, but rather just "to codify case law as expressed in *Neal v. Clark*, which interpreted 'fraud' to mean

actual or positive fraud rather than fraud implied by law" 3 Collier on Bankruptcy ¶523.08[5], at 523-28 (16th ed.).

At bottom, petitioner's proffered interpretation of section 523(a)(2)(A) is irreconcilable with the text of the statute, the common-law torts that it incorporates, and the manner in which this Court has interpreted it. It is also irreconcilable with the "'well-known' guide that exceptions to discharge 'should be confined to those plainly expressed.'" *Kawaauhau v. Geiger*, 523 U.S. 57, 62 (1998) (quoting *Gleason v. Thaw*, 236 U.S. 558, 562 (1915)). The Fifth Circuit thus was correct to reject petitioner's argument that section 523(a)(2)(A) can apply to bar a debt that is not the product of some sort of misrepresentation that induced the creditor to part with whatever it is that gave rise to the debt.

III. Petitioner Could Not Prevail Even If The Court Were To Resolve The Question Presented In Its Favor.

Finally, this Court's review also is not warranted because even if this Court were to disagree with all three courts below as to the correct interpretation of section 523(a)(2)(A), that still would not change the ultimate outcome of this case. Respondent presented several alternative grounds in support of the judgment below, and while the Fifth Circuit saw no need to reach those issues, each is amply supported by the law and the facts. At a minimum, those issues could necessitate remand for further proceedings in a case that has already dragged on for over five years.

First, even if section 523(a)(2) did not require a misrepresentation that induced the creditor to part with something of value, petitioner would still need to

prove that respondent is liable for Chrysalis's debt as a matter of state law And to do so, petitioner must prove that respondent committed "actual fraud" under section 21.223(b) of the Texas Business Organization Code. The Bankruptcy Court and the District Court divided on how to interpret that state law provision, and the Fifth Circuit declined to resolve that disagreement in light of its holding that petitioner could not invoke section 523(a)(2)(A) anyway. Pet.App.6a. But Texas case law plainly supports the Bankruptcy Court's view that section 21.223(a) requires a misrepresentation to establish "actual fraud." *See* Pet.App.91a-92a (collecting cases). Even if it did not, the Fifth Circuit also declined to resolve respondent's alternative argument that the record does not support a finding of "actual fraud" even under the District Court's flawed reading of Texas law because, *inter alia*, the evidence does not support the Bankruptcy Court's finding that the transfers were not made for reasonably equivalent value. *See* Pet.App.3a n.1 (declining to resolve that question). To prevail on its claim that respondent owes it a debt that is nondischargeable under section 523(a)(2)(A), petitioner would need to prevail on all of those state law and evidentiary issues as well.

Moreover, even assuming petitioner could pierce the corporate veil to hold respondent liable for Chrysalis's debt, as noted, every court to consider the question agrees that section 523(a)(2)(A) applies only when "the debtor intended by the transfer to hinder his creditors," not when "the only evidence of [fraud] is the inadequacy of the consideration" for the transfer. 217 F.3d at 894; *see also In re Lawson*, 791 F.3d at 220. Although petitioner repeatedly tries to

portray this case as fitting into the former category, as noted, the courts below in fact did not find that respondent acted with intent to defraud for purposes of section 523(a)(2)(A). While the Bankruptcy Court found that he caused transfers to be made "without Chrysalis receiving reasonably equivalent value," Pet.App.81a, it did not find that he did so with intent to defraud petitioner. And each court below found, in the course of rejecting petitioner's section 523(a)(6) claim, that petitioner failed to prove that respondent "made the[] transfers *with the intent to harm*" petitioner. Pet.App.18a (emphasis added). That alone ought to suffice to defeat any argument that respondent committed the kind of "actual fraud" that the Seventh and First Circuits think section 523(a)(2)(A) covers, but at a bare minimum it is an alternative grounds for affirmance that unquestionably remains open to respondent.

All of that said, if the Court were inclined to resolve the question presented, it should do so in this Chapter 7 case, rather than the Chapter 13 context in which *In re Lawson* resolved it. As evidenced both by the foregoing and by the opinions in the two cases, the correct interpretation of section 523(a)(2)(A) may depend at least in part on the interpretation of provisions such as sections 523(a)(6) and 727(a)(2)—provisions that apply in Chapter 7 but not Chapter 13 proceedings. While it may matter a great deal to a Chapter 7 debtor whether those provisions are given a narrow or a broad reading, the same cannot necessarily be said of a Chapter 13 debtor. Moreover, this case also has the virtue of involving a full trial on all exceptions invoked, which would give the Court a more complete sense of the interplay between the facts

and the law, as well as among the potentially relevant statutory provisions. *In re Larson*, by contrast, was resolved on a motion to dismiss with no factual development. Accordingly, although the question presented does not arise with sufficient frequency to warrant its resolution in either context, if the Court is inclined to resolve it, it should do so in this Chapter 7 case, or at least in this case in combination with *In re Lawson*, so that the Court can fully consider the implications of the arguments in both contexts.

CONCLUSION

The Court should deny the petition.

Respectfully submitted,

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